DOWNEY | BRAND
ATTORNEYS LLP

Scott L. Shapiro
sshapiro@downeybrand.com
916/520-5234 Direct
916/520-5634 Fax

621 Capitol Mall, 18th Floor
Sacramento, CA 95814
916/444-1000 Main
916/444-2100 Fax
downeybrand.com

MEMORANDUM

To: CENTRAL VALLEY FLOOD PROTECTION BOARD

From: SCOTT L. SHAPIRO

Date: FEBRUARY 9, 2009

Re: **CALIFORNIA LAW ON LIABILITY OF JPA MEMBER AGENCIES**

cc: INTERESTED LOCAL AGENCIES

The community of local agencies affected by the Central Valley Flood Protection Board's (Flood Board) policy on indemnification of Joint Power Agency (JPA) member agencies greatly appreciates the Flood Board's creation of a subcommittee to examine this issue. In the interest of a full exchange of information, and because the community believes that the best public policy can be made when policy-makers fully understand the issue, the community has authorized me to provide this information to the Flood Board.[1]

SUMMARY

This memorandum provides legal research that supports the following summary of the law of the State of California on potential JPA liabilities:

- In general, a JPA member agency ***is or is not*** liable for the liabilities of the JPA in the following six circumstances, all of which are summarized in Exhibit A attached:[2]

    - Where a JPA is found liable in tort, its member agencies ***are liable*** for that tort, during the life of the JPA.

    - Where a JPA would be found liable in tort, its member agencies ***are liable*** for that tort, even after the life of the JPA.

    - Where a JPA is found liable for breach of contract, its member agencies ***are not liable*** for that breach, during the life of the JPA.

[1] Despite distributing this memorandum, my clients are reserving the attorney-client privileged applicable to all other attorney-client communications.

[2] These statements all assume that the JPA has taken all legally-allowed actions to attempt to immunize the JPA member agencies from the liabilities of the JPA itself.

- Where a JPA would be found liable for breach of contract, its member agencies ***are not liable*** for the breach, even after the life of the JPA.

- Where a JPA is found liable in inverse condemnation, ***it is not clear whether its member are liable*** for that inverse condemnation, during the life of the JPA.

- Where a JPA would be found liable in inverse condemnation, ***it is very likely that its member agencies would be liable*** for that inverse condemnation, even after the life of the JPA.

- The Flood Board's Standard Condition #10 requiring indemnity by the permittee would likely be treated by the law as a contract. Where the permittee is one of the five JPAs create to provide protection (Flood Control JPAs), then liability would or would not lie for the member agencies as follows:

    - If the State is sued by an injured party in tort or inverse condemnation arising out of an encroachment permitted by the Flood Board, then under Standard Condition #10 the Flood Control JPA could be required to indemnify the State, but the Flood Control JPA member agencies would not be required to do the same. This conclusion is the same during or after the life of the Flood Control JPA.

    - In contrast, if the State ***and the Flood Control JPA*** are sued by an injured party in tort arising out of an encroachment permitted by the Flood Board, then under Standard Condition #10 the Flood Control JPA could be required to indemnify the State, and the Flood Control JPA member agencies would be liable to the extent that the Court found the Flood Control JPA itself to have some liability in tort.

- Under the terms of the joint power agreements that created Three Rivers Levee Improvement Authority (TRLIA) and San Joaquin Area Flood Control Agency (SJAFCA), these two Flood Control JPAs cannot dissolve while they have outstanding "material contracts" or "obligations," respectively. This means that if the Cooperation Agreements they execute with, and the permits they receive from, the Flood Board are "material contracts" and "obligations," respectively, then they will not be able to dissolve unless agreed to by the Flood Board. No such limitation currently exists for the other three Flood Control JPAs (Sacramento Area Flood Control Agency (SAFCA), Sutter Butte Flood Control Agency (SBFCA), and West Sacramento Area Flood Control Agency (WSAFCA)).

- One can only purchase insurance which protects the insured (and other named parties) from liability ***based upon the fault of the insured***. In other words, one's insurance policy will only cover liability if a court finds some degree of fault on the part of the insured. The Flood Board's standard indemnity provision (no. 10) requires the permittee (or in the case of TRLIA, the permittee and its member agencies) to indemnify the State ***whether or not the permittee has any fault***. This means that to the extent the State is

seeking to be indemnified by the permittee/insured in circumstances where the permittee/insured has no fault, the permitee/insured's insurance policy will not pay on the claim. In light of this, the Flood Board should revise its indemnity provision to be fault-based, consistent with industry standards.

BACKGROUND

Under the Joint Exercise of Powers Act, Government Code sections 6500 *et seq.*, ("JPA Act"), the Legislature granted public agencies the power to execute an agreement ("Agreement") to form a JPA for the purpose of jointly exercising any power common to the contracting agencies. Gov't Code § 6502. The resulting JPA is a separate legal entity from the parties to the Agreement. *Id.* § 6507. Various public agencies in the Central Valley have formed JPAs for the purpose of performing flood control work. The resulting JPAs are SAFCA, TRLIA, SJAFCA, WSAFCA, SBFCA (collectively referred to herein as the "Central Valley Flood Control JPAs").

The Flood Board issues permits to entities that intend to perform flood control work on facilities for which the State has provided assurance to the Army Corps of Engineers. Under its current practice, the Flood Board includes an indemnification provision in each of the permits it issues requiring the permit holder to indemnify the Flood Board for any liabilities that arise in association with the exercise of the permit. The Flood Board has received applications from the various Central Valley Flood Control JPAs to perform flood control projects. Given the legal distinction between the JPA and the parties forming the JPA (referred to herein as the "member agencies"), the question has arisen whether member agencies are accountable for the liabilities of a JPA. The Flood Board has indicated that, if the JPA cannot provide a meaningful indemnification and the member agencies are not responsible for the JPA's liabilities, the Flood Board will require the member agencies to agree to indemnify the Flood Board for any liabilities that arise in association with the JPA's exercise of its permit.

This memorandum provides background research regarding whether the Flood Board would obtain any benefit from requiring indemnification from the member agencies when issuing permits to any of the Central Valley Flood Control JPAs. This memorandum analyzes the potential liabilities of JPA member agencies both while the JPA is in existence and following the dissolution of the JPA. This memorandum focuses on the liabilities specific to JPAs that exercise flood control powers: contracts, torts, and inverse condemnation.

This memorandum does not yet treat the issue of whether a Cooperation Agreement between the JPA and the State of California, entered into as a regulatory requirement of receiving an encroachment permit, is a contractual agreement between the State and the JPA to which Gov't Code section 6508.1 applies (as discussed below). This issue will be treated as a separate memorandum currently being developed.

DISCUSSION

A. Will the liabilities of a JPA pass through to its member agencies while the JPA is in existence?

1. The JPA's Contractual Liabilities will pass through to Member Agencies unless the JPA Agreement States Otherwise

Whether a JPA's contract liabilities and obligations pass through to its member agencies depends on the terms of the Agreement forming the JPA. The Legislature granted member agencies the power to dictate whether a JPA's liabilities will pass to the member agencies in section 6508.1 of the Government Code.

> If the agency is not one or more of the parties to the agreement but is a public entity, commission, or board constituted pursuant to the agreement, the debts, liabilities, and obligations of the agency shall be debts, liabilities, and obligations of the parties to the agreement, unless the agreement specifies otherwise.

Gov't Code § 6508.1.

The California Supreme Court and Court of Appeal have applied this provision when analyzing whether to hold member agencies responsible for a JPA's contractual obligations. *Rider v. City of San Diego* (1998) 18 Cal.4th 1035 ("*Rider*"); *Tucker Land Co. v. State of California* (2001) 94 Cal.App.4th 1191, 1200-1201. In *Tucker* the plaintiff sued member agencies of the Mountain Recreation and Conservation Authority (MRCA), a JPA, alleging that the member agencies were jointly and individually liable for MRCA's contractual liabilities where the plaintiff had already been awarded a judgment against MRCA for breach of contract. *Id.* at 1195. In analyzing the member agencies' liabilities, the Court of Appeal explained that,

> the Legislature intended section 6508.1 [of the Government Code] to mean [nothing] other than what it plainly says, that the debts of the JPA are the debts of the constituent entities *unless the agreement specifies otherwise*.

Id. at 1200-1201 (emphasis in original). In *Tucker*, the Agreement forming MRCA specifically stated that the member agencies would not be responsible for the debts of the JPA. *Id.* Thus, based on the plain language of section 6508.1, the court reasoned that the member entities were not responsible for MRCA's contractual liability. *Id.*

Likewise, in *Rider*, the San Diego Unified Port District ("Port District") and the City of San Diego ("City") created a JPA to set up an arrangement to finance the expansion of a convention center. *Rider*, 18 Cal.4th at 1040. The arrangement provided that the Port District would lease the existing convention center to the JPA for a nominal sum ($2.00). *Id.* The JPA would then

issue bonds to cover the costs of the expansion. *Id.* The JPA would also sublease the convention center to the City for rent to cover the JPA's bond debt and administrative expenses. *Id.* At the same time, the Port District would pay a large sum of money to the City to help with the City's expenses. *Id.* When the expansion was complete, the convention center would vest in the Port District and the JPA would terminate. *Id.* Plaintiffs challenged this financing arrangement, alleging that the JPA was really just a financing "shell" for the City and had no real existence separate from the City. *Id.* Thus, the plaintiffs urged the court to "look beyond the form of the transaction and recognize that, in substance, the City is liable for [the JPA's] debt." *Id.* at 1045. The Supreme Court rejected the plaintiffs' theory, citing Government Code section 6508.1 as authority for finding that the JPA's debts were not the City's debts. *Id.*

The holdings in *Rider* and *Tucker* demonstrate the strength of section 6508.1. If member agencies draft an Agreement forming a JPA to insulate the member agencies from liability, other than as discussed below, the JPA's obligations will not pass through to the member agencies. Conversely, if the JPA Agreement does not include such a provision, section 6508.1 of the Government Code allows third parties to recover obligations from the JPA's member agencies.

Each of the Agreements forming the Central Valley Flood Control JPAs contain a provision similar to the one in the MRCA Agreement. SJAFCA Joint Exercise of Powers Agreement at 20 ("The debts, liabilities and obligations of the Agency shall be the debts, liabilities or obligations of the Agency alone and not the Parties to this Agreement."); SAFCA Joint Exercise of Powers Agreement at 21 ("The debts, liabilities and obligations of the Agency shall be the debts, liabilities or obligations of the Agency alone and not of the Parties to this Agreement."); Joint Exercise of Powers Agreement By and Between the County of Yuba and Reclamation District No. 784, Creating the TRLIA at 9 ("The debts, liabilities and obligations of the Authority shall not be debts, liabilities and obligations of the County, the District, any Associate Member or any other Public Agency."); WSAFCA Joint Exercise of Powers Agreement at 13 ("The debts, liabilities and obligations of the Agency shall be the debts, liabilities or obligations of the Agency alone and not of the Parties to this Agreement."); SBFCA Joint Exercise of Powers Agreement at 13 ("The debts, liabilities and obligations of the Agency shall be the debts, liabilities or obligations of the Agency alone and not of the Parties to this Agreement."). Thus, like MRCA's member agencies, and except as noted below, the member agencies of SJAFCA, SAFCA, TRLIA, WSAFCA, and SBFCA cannot be held liable for the obligations of their respective JPAs.

2. Member Agencies Are Jointly and Severally Liable for the Torts of the JPA

The Legislature has spoken directly to the tort[3] liability of JPAs in section 895.2 of the Government Code.

> Whenever any public entities enter into an agreement, they are jointly and severally liable upon any liability which is imposed by any law other than this chapter upon any one of the entities or upon any entity created by the agreement for injury caused by a negligent or wrongful act or omission occurring in the performance of such agreement.

Gov't Code § 895.2. The California Court of Appeal addressed the scope of this statute in *Tucker* when analyzing MRCA's member agencies liabilities. Although the Court of Appeal determined that section 895.2 could not be used to impose contractual liability on member agencies, the law "imposes liability on each of the parties to a JPA to an injured party for any tort that may occur in the performance of the agreement for which any one of the entities, or the entity created by the agreement, is otherwise liable under the law." *Tucker*, 94 Cal.App.4th at 1198-1199 (citing to the Law Revision Commission comments to section 895) (emphasis added). This type of liability is commonly referred to as "joint and several liability." *See Tucker*, 94 Cal.App.4th at 1198 (referring to the tort liability of member agencies as "joint and several"); *see also* Rest.3d Torts: Apportionment of Liability § 10 (describing joint and several liability). Thus, under Government Code section 895.2, the member agencies of the Central Valley Flood Control JPAs could be held liable for the torts of their respective JPA.

3. Member Agencies Likely Are Not Responsible for a JPA's Inverse Condemnation Liabilities Unless Public Policy Considerations Dictate Otherwise

Whether the member agencies of a JPA can be held responsible for the inverse condemnation liabilities[4] of a JPA is a question that has received no treatment in California law. *Rider* and

[3] "A tort is 'any wrong not consisting in mere breach of contract, for which the law undertakes to give to the injured party some appropriate remedy against the wrongdoer." 5 Witkin Summary of Law § 1 (10th ed. 2005) (quoting *Denning v. State* (1899) 123 Cal. 316, 323).

[4] Inverse condemnation claims are based on section 19 of article I of the California Constitution, which requires that public agencies pay just compensation for taking or damaging private property for a public use. In an inverse condemnation action, the plaintiff must demonstrate (1) that the private property has been taken or damaged for public use, and (2) that a public entity "substantially participated" in the planning, approval, construction or operation of the public project or improvement. *San Diego Gas & Elec. Co. v. Superior Ct.* (1996) 13 Cal.4th 893, 940; *DiMartino v. City of Orinda* (2000) 80 Cal.App.4th 329, 336. If a plaintiff successfully satisfies these two elements, the plaintiff may recover damages based on market value and "reasonable costs, disbursements and expenses, including reasonable attorney, appraisal, and engineering fees, actually incurred because of such proceeding." Code Civ. Proc. § 1036.

Tucker, discussed above, are the only cases that analyze the liabilities of JPA member agencies. However, the Supreme Court analyzed only a contractual relationship and Court of Appeals' discussion in *Tucker* is limited to contractual obligations and torts. Neither case even mentions inverse condemnation. Given the lack of law on this subject, there are two possible scenarios regarding whether a JPA's inverse condemnation liabilities pass through to its member agencies. The following subsections describe both possible scenarios.

a. *Alternative 1: Government Code § 6508.1 Governs Inverse Condemnation Liability*

The first possibility is that section 6508.1 of the Government Code governs. As explained above in section III(A)(1), Government Code section 6508.1 provides that the debts, obligations, and liabilities of a JPA will be the debts, obligations, and liabilities of the member agencies unless the Agreement forming the JPA states otherwise. The language of section 6508.1 is very broad; indeed, there is nothing in the plain language of section 6508.1 that would suggest the statute does not apply to a JPA's inverse condemnation liabilities. Thus, if section 6508.1 applies in the inverse condemnation realm, member agencies could insulate themselves from the JPA's inverse condemnation liabilities by including limiting language in the JPA Agreement.

As explained above, each of the Central Valley Flood Control JPA Agreements includes such limiting language. SJAFCA Joint Exercise of Powers Agreement at 20; SAFCA Joint Exercise of Powers Agreement at 21; Joint Exercise of Powers Agreement By and Between the County of Yuba and Reclamation District No. 784, Creating the TRLIA at 9; WSAFCA Joint Exercise of Powers Agreement at 13; SBFCA Joint Exercise of Powers Agreement at 13. These language of these provisions is broad. *Id.* Thus, if Government Code section 6508.1 governs the inverse condemnation liabilities of a JPA, none of the member agencies could be held responsible for their respective Central Valley Flood Control JPA's inverse condemnation liabilities.

b. *Alternative 2: Public Policy Considerations Might Persuade Courts to Impose Liabilities on Member Agencies*

Depending on factual circumstances, application of Government Code section 6508.1 in the inverse condemnation realm might run afoul of public policy. Case law demonstrates that, where a cause of action for inverse condemnation lies, there is a strong constitutional interest in protecting private individuals from the burden of bearing a disproportionate share of the costs of flood damages. *Paterno v. State of California* (2003) 113 Cal.App.4th 998, 1015-1016, 1019-1020 ("*Paterno*"). Flood control projects benefit the community at large and, thus, it is fair to expect the community to pay for damage caused by the failure of a public flood control project. *Id.* at 1018-1020. Moreover, one of the important factors that courts consider when determining whether to assign inverse condemnation liability is which party can best absorb the costs of flood damages. *Id.* at 1025, 1027. This factor tips in favor of assigning liability to public entities. "[T]he cost of such damage can better be absorbed, and with infinitely less hardship, by the taxpayers as a whole than by the owners of the individual parcels damaged." *Id.* at 1018.

As long as the member agencies form a JPA with sufficient financial resources to cover the costs associated with inverse condemnation, it will not be necessary for courts to consider whether the member entities should bear the financial burden associated with flood damage. However, if a flood control JPA has insufficient financial resources to satisfy the costs associated with inverse condemnation liability, restricting financial responsibility to only the JPA would frustrate the public policies described above. In such a scenario, individual landowners would be saddled with the costs of repairing flood damage to their properties. In these circumstances, it is conceivable that a court would look beyond the JPA to the member agencies for compensation. The court, in this case, would be finding that the Constitutional guarantee of compensation for inverse condemnation overrides the Legislature's attempt to insulate member agencies from the liabilities of their created JPA. The court would argue that flood control projects benefit landowners within each member agencies' boundaries. Another justification could be that, because the member agencies set up the JPA's financial arrangements through the JPA Agreement, the member agencies are responsible for the JPA's limited financial resources.

Whether a court is likely to hold member agencies responsible for a JPA's liabilities will probably depend on the specific facts of a case. However, the member agencies of the Central Valley Flood Control JPAs should be aware that public policy concerns could convince a court to disregard the plain language of Government Code Section 6508.1 and hold member agencies responsible for inverse condemnation should a flood occur.[5]

B. What happens to JPA liabilities and obligations upon dissolution?

1. A JPA's Contract Liabilities Will Not Attach to Member Agencies Upon Dissolution of the JPA

The JPA Act does not address what happens to a JPA's liabilities following a dissolution. An informal Attorney General Opinion ("AG Opinion"), written in 2001, opines that the effect of this omission is that the JPA's debts and obligations cease following dissolution of the JPA unless the JPA Agreement directs otherwise. Letter from Jennifer K. Rockwell, Deputy Attorney General, to Paul G. Smith, Esq., General Counsel, California State Library regarding Joint Powers Authority as Applicant Under the Library Bond Act at 3-4 (Sept. 4, 2001). In support of this conclusion, the AG Opinion accurately notes that the Legislature directed member agencies to identify a distribution system for the JPA's proceeds and assets upon dissolution, but fails to

[5] Alternatives 1 and 2 are the only conceivable outcomes following an analysis of whether member agencies are responsible for a JPA's inverse condemnation liabilities because the only potentially applicable legal principles are found in Government Code section 1608.1 and public policy. Government Code section 895.2 would not apply in this situation because section 895.2 only covers "negligent or wrongful act[s] or omission[s]." According to the California Supreme Court, "[a] constitutional analysis for determining inverse condemnation liability in the flood control context should not include 'a fruitless search for the somewhat artificial moral elements inherent in the tort concepts of negligent and intentional wrongs." *Bunch v. Coachella Valley Water Dist.* (1997) 15 Cal.4th 432, 449 (quoting Van Alstyne, *Inverse Condemnation: Unintended Physical Damage* (1969) 20 Hastings L.J. 431, 495); *id.* at 436 ("This inverse condemnation rule invokes constitutional balancing principles and is not governed by tort concepts of fault or negligence.").

include a similar provision addressing the distribution of the JPA's liabilities upon dissolution. *Id.* (citing Gov't Code §§ 6511-6512.2). Thus, although the Legislature recognized that the dissolution of JPAs would result in various legal issues, the Legislature's failure to address liabilities suggests that the Legislature intended that there not be a statutory requirement for liabilities to be distributed upon dissolution of a JPA. *Palermo v. Stockton Theatres, Inc.* (1948) 32 Cal.2d 53, 62 ("The fact that similar language was not used by our Legislature may be thought to constitute some evidence of the fact that such a result was not intended.").

With respect to contractual liabilities, the AG Opinion's conclusion comports with public policy considerations. The law holds people accountable for their actions in a variety of legal settings where they knew or should have known that there was a risk of legal consequences. For example, in real estate transactions, the historical legal doctrine of *caveat emptor* (buyer beware), "requires the purchaser to avail himself of all the means of information at hand to ascertain the quality of the property and the character and extent of the title . . . ." *Mains v. City Title Insurance Co.* (1949) 34 Cal.2d 580, 583. In essence, a buyer cannot seek a remedy in the courts for a real estate transaction gone awry when the buyer could have avoided the problems by researching available information. In the same vein, courts apply the rule "ignorance of the law is no excuse" or "mistake of law" in criminal cases where a defendant claims that he was unaware that his actions constituted a crime. *Cheek v. United States*, 498 U.S. 192, 199 ("The general rule that ignorance of the law or a mistake of law is no defense to criminal prosecution is deeply rooted in the American legal system."). "Based on the notion that the law is definite and knowable, the common law presumed that every person knew the law." *Id.*

Although the issue of JPA liabilities does not trigger application of the doctrines of *caveat emptor* or "mistake of law," the underlying policy for these doctrines (encouraging people to make themselves aware of the factual and legal circumstances) is relevant here. As explained above, the law is clear that JPA member agencies may draft the JPA Agreement to insulate the member agencies from the JPA's obligations; as explained below in light of section 895.2 this means contractual obligations. *See supra* Section III(A)(1). A party contracting with a JPA has the ability to make itself aware of whether the relevant JPA Agreement contains this legal limitation. Likewise, before entering into the contract, the contracting party has the opportunity to structure the contract to require that another entity (or entities) take on the JPA's obligations should the JPA dissolve while the contract is in effect.[6] Thus, if the party contracting with a JPA performs the necessary due diligence prior to entering into a contract with the JPA, the third party can avoid the risks associated with the potential dissolution of the JPA. Therefore, like the justification for the doctrines of *caveat emptor* and "mistake of law," it is unnecessary for the law to provide a means to protect the contracting party from its failure to educate and protect itself from potential legal repercussions.

[6] For example, the contracting party could require that one or more of the member agencies agree to assume the JPA's obligations. Government Code section 6508.1 specifically allows JPA member agencies to enter into contracts to assume a JPA's debts, obligations, or liabilities. Gov't Code § 6508.1.

The Agreements forming SBFCA, WSAFCA, and SAFCA do not address the disposition of liabilities upon dissolution.[7] *See, generally,* SBFCA Joint Exercise of Powers Agreement, WSAFCA Joint Exercise of Powers Agreement, and SAFCA Joint Exercise of Powers Agreement. Thus, as outlined above, if SBFCA, WSAFCA, or SAFCA dissolve prior to the completion of their respective contracts, any remaining contractual duties would likely dissolve along with the JPA unless a third party has already agreed to assume the JPA's obligations.

The Agreements governing the remaining two Central Valley Flood Control JPAs, TRLIA and SJAFCA, contain provisions restricting dissolution while obligations or potential obligations are outstanding. TRLIA's Joint Exercise of Powers Agreement states,

> This Agreement shall become effective, and the Authority shall come into existence, on the date of execution and delivery hereof, and this Agreement and the Authority shall thereafter continue in full force and effect for at least forty (40) years (unless earlier terminated by unanimous vote of the Members and any then Associate Members), but in any event so long as either (a) any Bonds remaining outstanding or any material contracts to which the Authority is a party remain in effect, or (b) the Authority shall own any interest in any Public Improvements or land.

Joint Exercise of Powers Agreement by and between the County of Yuba and Reclamation District No. 784 creating the TRLIA at 10. Likewise, the SJAFCA Joint Exercise of Powers Agreement states,

> This Agreement may be rescinded and the Agency terminated by unanimous written consent of the Parties; provided that no such termination or rescission shall occur so long as the Agency has any obligations (including, but not limited to, outstanding revenue bonds).

SJAFCA Joint Exercise of Powers Agreement at 21.

These provisions provide certainty to any parties contracting with TRLIA or SJAFCA that TRLIA and SJAFCA will satisfy their legal obligations before a dissolution can occur. If the member agencies of TRLIA or SJAFCA were to violate these provisions and attempt to terminate the JPA before the JPA satisfied all of its contractual obligations, the injured party likely would be able to seek relief from the member agencies. California law recognizes the

[7] The Agreements governing TRLIA and SJAFCA also do not address the disposition of liabilities upon dissolution. *See, generally,* Joint Exercise of Powers Agreement by and between the County of Yuba and Reclamation District No. 784 creating the TRLIA, and SJAFCA Joint Exercise of Powers Agreement. As the following paragraphs explain, however, the TRLIA and SJAFCA Agreements contain different provisions that impact the contractual liability and dissolution issue.

right of a third party to enforce an agreement that is made for the third party's benefit. *See, e.g., Brown v. Superior Court* (1949) 34 Cal.2d 559, 564 (where there was an agreement to make mutual wills in favor of third persons, the third persons were entitled to enforce the rights as third party beneficiaries); *see also* 1 Witkin Summary of California Law § 685 *et seq.* (10th ed. 2005).

2. Member Agencies Will Remain Jointly and Severally Liable for a JPA's Torts Following Dissolution of the JPA

As explained above, member agencies are jointly and severally liable for the torts of a JPA. *See, supra,* section III(A)(2). Thus, with respect to torts, it is unnecessary to analyze whether a JPA's liabilities will be distributed upon dissolution; tort liability is distributed among the JPA's member agencies as soon as the tort occurs. Gov't Code § 895.2. Whether any of the Central Valley Flood Control JPAs dissolve will not affect the joint and several liability of the member agencies for their respective JPA's torts.

3. Public Policy Considerations Indicate that Member Agencies Likely Would Be Responsible for a JPA's Inverse Condemnation Liabilities Following the JPA's Dissolution

As explained above, California law has not analyzed the liabilities associated with inverse condemnation where a JPA is involved. Thus, there is no clear indication whether a JPA's inverse condemnation liabilities would distributed to the member agencies upon the JPA's dissolution.

One potential outcome could be that strict application of Government Code section 6508.1 controls. Under this scenario, inverse condemnation liabilities would follow the same path as the JPA's contractual liabilities. *See, supra,* Section III(B)(1) (discussing the disposition of contractual liabilities following dissolution of a JPA). Thus, if the JPA Agreement is silent regarding the liabilities of its member agencies, the member agencies would be responsible for the JPA's inverse condemnation liabilities and would remain responsible following the JPA's dissolution. If the JPA agreement insulates the member agencies from the JPA's liabilities, the inverse condemnation liabilities would terminate upon dissolution of the JPA.

It seems unlikely, however, that a court would allow a JPA's inverse condemnation liabilities to ever terminate upon dissolution of the JPA, even if the JPA Agreement includes a provision insulating the member agencies from the JPA's liabilities. Unlike a contractual arrangement, the injured party in an inverse condemnation case did not voluntarily enter into a relationship with the JPA. Thus, the injured party did not have an opportunity to protect itself should the JPA dissolve before compensating the injured party for its property damage. Therefore, the justifications for why a JPA's contractual obligations could cease upon termination of the JPA do not appear to apply when analyzing the disposition of inverse condemnation liabilities.

Moreover, public policy considerations strongly suggest that a JPA's inverse condemnation liabilities cannot simply dissolve along with the JPA. If JPA member agencies were insulated

from a dissolved JPA's inverse condemnation liabilities, individual landowners would have no where to turn for financial relief. This is contrary to principles set forth in *Paterno*, that the law favors protecting private landowners from bearing the burden of flood damages and distributing the cost of flood damages among community members that receive benefits from public flood control projects. *See supra*, Section III(A)(3)(b) (discussing the public policies described in *Paterno v. State of California* (2003) 113 Cal.App.4th 998).

Finally, allowing a JPA and its member agencies to avoid inverse condemnation liabilities through dissolution would set bad precedent. Although California law has not addressed the effect of JPA dissolutions, it has addressed the dissolution of joint ventures. Joint ventures are conceptually similar to JPAs, except that joint ventures are private business entities formed by two or more other private entities to carry out a specific business enterprise for profit. *See e.g., In the Matter of the Appeal of Miller/Thompson J.D. Steel, Harris, Rebar, A Joint Venture*, 2001 Cal. OSHA App.Bd. LEXIS 182, *7 (2001). Although the California Corporations Code specifically governs the disposition of joint venture's contractual and tort liabilities upon dissolution, it does not answer whether the joint venture's constituent business entities assume the joint venture's administrative penalties following dissolution. *Id.* at * 4. A 2001 administrative decision from the California Occupational Safety and Health Appeals Board ("Cal OSHA") addressed such a situation, explaining that it would be unjust to allow constituent entities to make a conscious decision to disband after receiving citations as a means of evading civil penalties. *Id.* at *11. Even if the constituent entities did not make a conscious decision to evade civil penalties, Cal OSHA explained that the deterrent aspect of civil penalties would be lost if constituent entities were not held responsible following the dissolution of a joint venture. *Id.*

Cal OSHA's justifications for applying a dissolved joint venture's civil penalties to its constituent entities are equally applicable to JPAs and member agencies. If the law failed to hold JPA member agencies responsible for the inverse condemnation liabilities of dissolved JPAs, the omission would create a loophole in the law; member agencies could evade liability for inverse condemnation by creating and dissolving JPAs whenever the risk of inverse condemnation arose.

As demonstrated above, numerous public policy reasons exist to hold member agencies responsible for a dissolved JPA's inverse condemnation liabilities regardless of the terms of the JPA Agreement. Thus, even though each of the Agreements forming the Central Valley Flood Control JPAs contain a provision insulating the member agencies from the JPA's liabilities, a strong likelihood exists that a court would hold the member agencies responsible for the JPA's inverse condemnation liabilities following the JPA's dissolution.

C. Effect of the Flood Board's Standard Permit Term #10

This section of the memorandum analyzes whether the Flood Board's standard term regarding indemnification would obligate both the a Flood Control JPA and its member agencies. The standard term ("Term No. 10") reads, in relevant part,

> If any claim of liability is made against the State of California, or any departments thereof, the United States of America, a local district or other maintaining agencies and the officers, agents or employees thereof, the permittee shall defend and shall hold each of them harmless from each claim.

Term No. 10 is an express indemnity provision that would create only a duty flowing from the Flood Control JPAs to the State, its departments, other agencies, the United States, and any agents, officers and employees thereof (collectively, the "State"). Term No. 10 would not make the Flood Control JPAs jointly and severally liable for the State's liabilities to injured third parties. This memorandum ultimately concludes that a Flood Control JPA's indemnification obligation under Term No. 10 would not pass through to its member agencies because the obligation is distinct from the type of liabilities (tort and, perhaps, inverse condemnation) that do pass through from the Flood Control JPAs to their member agencies.

1. Term No. 10 is an Express Indemnification Provision.

Indemnity is "the obligation resting on one party to make good a loss or damage another has incurred." *E.L. White, Inc. v. City of Huntington Beach* (1978) 21 Cal.3d 497, 506 ("*White*"). California law recognizes only two forms of indemnity: equitable indemnity and express indemnity. *Id.* at 506-507. Express indemnity arises from an agreement between the parties regarding the scope of indemnity that the indemnitor will provide to the indemnitee. *Id.* at 507. "[T]he parties to an express indemnity provision may, by the use of sufficiently specific language, establish a duty in the indemnitor to save the indemnitee harmless . . . ." *Id.* (emphasis removed).

On the other hand, equitable indemnification "applies only among defendants who are jointly and severally liable to the plaintiff." *BFGC Architects Planners, Inc. v. Forcum/Mackey Construction, Inc.* (2004) 119 Cal.App.4th 848, 852 ("*BFGC Architects*") (noting that "joint and several liability" is not limited simply to "joint tortfeasors" but also to "acts that are concurrent or successive, joint or several, as long as they create a detriment caused by several actors"). "Generally, [equitable indemnity] is based on a duty owed to the underlying plaintiff." *Id.*

Although inclusion of Term No. 10 in encroachment permits suggests that it was less the result of "agreement" between the parties than it was a unilateral imposition by the Flood Board, the express language of the provision does set forth the scope of the indemnity. More importantly, Term No. 10 creates the duty to indemnify in the permittee; the duty does not arise from an action of the permittee that caused injury to a third party.[8] These distinctions demonstrate that Term No. 10 is a form of express indemnity, not equitable indemnity.

[8] This memorandum is limited to analyzing a JPA's duty to indemnify under Term No. 10. This memorandum does not analyze the type of indemnification that could arise if a JPA and the State were jointly and severally liable for damage to a landowner from a flood event.

2. Term No. 10 Would Create A Duty Flowing From the Flood Control JPAs to the State Only.

An express indemnification provision does not make an indemnitor jointly and severally liable to the injured party. *See Culley & Associates v. Superior Court* (1992) 10 Cal.App.4th 1484, 1492 (explaining that the underlying principles of equitable indemnity do not apply to express indemnity). Instead, an express indemnification provision obligates the indemnitor to make the indemnitee whole. *See White*, 21 Cal.3d at 507 (characterizing an express indemnity duty as "a duty in the indemnitor to save the indemnitee . . . ."). Thus, an indemnitor's duty to the indemnitee is a separate responsibility from the indemnitee's liability to an injured third party.

For example, if a Flood Control JPA obtained an encroachment permit and the State was subsequently found liable to a landowner for tort, the State could seek indemnification from the Flood Control JPA under Term No. 10. This would obligate the JPA to reimburse the State for the State's costs associated with its tort liability. Term No. 10 would not permit the injured property owner to seek compensation from the JPA directly, however, because the Flood Control JPA's duty is to the State only, and not to the injured party.

3. A JPA's Duty to Indemnify Will Not Pass Through To Member Agencies.

There is precedent indicating that an express indemnification duty is a form of contractual liability. Civil Code § 2772 ("Indemnity is a *contract* by which one engages to save another from a legal consequence of the conduct of one of the parties, or of some other person") (emphasis added); *White*, 21 Cal.3d at 507 ("so-called 'express' indemnity reflect[s] its *contractual* nature") (emphasis added). On the other hand, there is some case law suggesting that a state-issued permit or license, such as an encroachment permit from the Flood Board, is legally distinct from a contract. *Hevren v. Reed* (1899) 126 Cal. 219, 222 (stating that a liquor license "is neither a contract nor property").

Whether the express indemnity provision in Term No. 10 gives rise to a contractual obligation or is a unique type of legal obligation associated with state-issued permits, section 6508.1 of the Government Code applies. As explained in the December 24 Memo, through section 6508.1, the Legislature granted member agencies the power to dictate whether a JPA's liabilities will pass through to the member agencies.

> If the agency is not one or more of the parties to the agreement but is a public entity, commission, or board constituted pursuant to the agreement, the debts, liabilities, and obligations of the agency shall be debts, liabilities, and obligations of the parties to the agreement unless the agreement specifies otherwise.

Gov't Code § 6508.1. The only type of liability that courts have held to be outside the scope of section 6508.1 is tort liability because the Legislature enacted a different statute specifically

stating that tort liabilities pass through to the JPA's member agencies.[9] *See* Gov't Code § 895.2. In this case, the indemnification obligation created by Term No. 10 is not a tort liability because it does not arise out of a negligent or intentional wrong. *See Bunch v. Coachella Valley Water Dist.* (1997) 15 Cal.4th 432, 449 (describing the concept of tort as being related to "moral elements . . . of negligent and intentional wrongs"). Thus, Government Code section 6508.1 governs whether the member agencies would be held responsible for the indemnification obligations of the Flood Control JPAs under Term No. 10.

Each of the Agreements forming the Flood Control JPAs contains a provision insulating member agencies from the obligations, debts, and liabilities of the JPA. SJAFCA Joint Exercise of Powers Agreement at 20 ("The debts, liabilities and obligations of the Agency shall be the debts, liabilities or obligations of the Agency alone and not the Parties to this Agreement"); SAFCA Joint Exercise of Powers Agreement at 21 ("The debts, liabilities and obligations of the Agency shall be the debts, liabilities or obligations of the Agency alone and not of the Parties to this Agreement"); Joint Exercise of Powers Agreement By and Between the County of Yuba and Reclamation District No. 784, Creating TRLIA at 9 ("The debts, liabilities and obligations of the Authority shall not be the debts, liabilities and obligations of the County, the District, any Associate Member or any other Public Agency"); WSAFCA Joint Exercise of Powers Agreement at 13 ("The debts, liabilities and obligations of the Agency shall be the debts, liabilities or obligations of the Agency alone and not of the Parties to this Agreement"); SBFCA Joint Exercise of Powers Agreement at 13 ("The debts, liabilities and obligations of the Agency shall be the debts, liabilities or obligations of the Agency alone and not of the Parties to this Agreement"). Thus, under Government Code section 6508.1, a Flood Control JPA's indemnification obligation to the State—whether a contractual obligation or a distinct form of a legal obligation arising from the State-permittee relationship—would not pass through to its member agencies.

D. Promises of Indemnity Are Only Insurable If they Are Fault Based

One can only purchase insurance which protects the insured (and other additionally named parties) from liability based upon the fault of the insured. The following language is typical of insurance policies on this issue:

> *"We will pay those sums that the insured becomes legally obligated to pay as damages because of bodily injury or property damage . . . ."*

or

[9] As explained above, inverse condemnation liability might also fall outside the scope of section 6508.1 for public policy reasons. To date, no court has specifically addressed this issue.

> *"The Authority will reimburse the covered party for ultimate net loss in excess of the Retained Limit hereinafter stated which the covered party shall become legally obligated by reason of liability imposed by law. . . ."*

In other words, liability insurance policies are intended to only cover liability if a court finds some degree of fault (legal obligation) on the part of the insured. However, the operation of an indemnity provision in general is not considered a "legal obligation" to which the insurance policy attaches. Specifically, liability insurance policies include an "extension" under the contractual liability portion of the policy to specifically cover indemnity agreements made between the insured and other parties. However, the contractual liability coverage itself is limited to only covering bodily injury or property damage "that the insured would have in the absence of the contract or agreement." In short, even with the "extension," there must still be some legal obligation of the insured ***other than the indemnity promise itself,*** for the insurance policy to provide coverage either directly on behalf of the insured or through the contractual liability extension covering an indemnity promise.

The Flood Board's standard term no. 10, an express indemnity provision, reads, in relevant part,

> If any claim of liability is made against the State of California, or any departments thereof, the United States of America, a local district or other maintaining agencies and the officers, agents or employees thereof, the permittee shall defend and shall hold each of them harmless from each claim.

Note that the language of this provision obligates the permittee to indemnify the Flood Board for "any claim of liability" made against the State of California. As drafted this provision is so broad as to arguably include indemnity even for activities other than those allowed by the permit. However, even by inferring a reasonable reading of the provision such that the indemnity would only apply to liability arising out of the permit, the standard term still seeks to impose that indemnity whether or not the permittee has any fault or legal obligation to accept the claim. In short, the indemnity requirement is so vague and overbroad that it is doubtful that a liability policy would provide the coverage both the permittee and the Flood Board are counting on in the event of a claim and as called for to issue a permit.

A standard indemnity provision should recognize that one cannot obtain insurance to cover an indemnity which is not fault based. Therefore, the Flood Board should revise its indemnity provision to be fault based, consistent with industry standards. The following provision would recognize the appropriateness of a fault based indemnity and would provide the basis for liability insurance to cover the indemnity:

> To the extent allowed by State law, the permittee shall indemnify, defend, and hold harmless the State of California, or any departments thereof, the United States of America, and any local district or other maintaining agencies, and the officers, agents, or employees thereof, from and against any claims, demands, actions, losses, liabilities, damages, and costs incidental thereto arising out of this permit, including reasonable cost of defense, settlement, arbitration, and attorneys' fees, but only to the extent caused by the negligent or wrongful act or omission of the permittee, its officers, agents, or employees or the act or omission of anyone else directly acting on behalf of the permittee for which the permittee is legally liable under law.

It is a well established principle that express indemnity provisions should never be written beyond the scope of the permittee's insurance coverage if the indemnified party (Flood Board) wants the assurances that the indemnifying party will have the financial resources to make good on the promised indemnity. To violate this principle will put both the permittee and the indemnified party at unnecessary risk because insurance – not the promises or assets of the indemnifying party – is the best and most practical and cost-effective method to meet indemnity obligations.

A further concern with the standard indemnity provision is that it appears to seek to provide an indemnity to the State from the permittee, even where the future liability could have arisen from the State's or Federal Government's own negligence or misconduct. However, California law precludes a party from attempting to shift liability for its own negligence when the public interest is involved. *See Tunkl v. Regents of University of California* (1963) 60 Cal.2d 92, 98-101; *Caza Drilling (California) Inc. v. TEG Oil & Gas U.S.A.* (2006) 142 Cal.App.4th 453, 468. (Exculpatory clauses relieving a party from the consequences of its own negligence cannot be enforced where the public interest is involved even if the conduct does not involve a violation of law.) The effect of these cases could be to completely invalidate the indemnity clause.

For all of these reasons, the Board should consider revising its indemnity accordingly.

DOWNEY | BRAND ATTORNEYS LLP

Scott L. Shapiro
sshapiro@downeybrand.com
916/520-5234 Direct
916/520-5634 Fax

621 Capitol Mall, 18th Floor
Sacramento, CA 95814
916/444-1000 Main
916/444-2100 Fax
downeybrand.com

Exhibit A

	Contract Liability	Tort Liability	Inverse Condemnation Liability
Responsibility Of Member Agencies For JPA Liabilities While The JPA Is In Existence	Member agencies are liable for contractual obligations *unless the JPA agreement states otherwise*. (Gov't Code § 6508.1.) All five of the Central Valley Flood Control JPA Agreements contain provisions stating that the liabilities of the JPA are not the liabilities of the member agencies.	Member agencies are jointly and severally liable for the torts of the JPA. (Gov't Code § 859.2.)	Two Possible Outcomes: 1. Member agencies are responsible for inverse condemnation liabilities *unless the JPA agreement states otherwise*. (Gov't Code § 6508.1.) 2. Depending upon the facts of the case, a court might rely on public policy considerations and hold member agencies responsible for the JPA's inverse condemnation liabilities.
Responsibility Of Member Agencies For JPA Liabilities Following Dissolution Of The JPA	Member agencies are liable for contractual obligations *unless the JPA agreement states otherwise*. (Gov't Code § 6508.1.) All five of the Central Valley Flood Control JPA Agreements contain provisions stating that the liabilities of the JPA are not the liabilities of the member agencies.	Member agencies are jointly and severally liable for the torts of the JPA. (Gov't Code § 859.2.)	Both of the possible outcomes listed above could govern the disposition of a JPA's inverse condemnation liabilities following dissolution, but public policy considerations are particularly important in this situation. Thus, it is likely that member agencies would be responsible for a JPA's inverse condemnation liabilities following the JPA's dissolution.